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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1965

No. 1190

J. STRICKLAND & CO.,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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SUPREME COURT OF THE UNITED STATES

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J. STRICKLAND & CO.,
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UNITED STATES OF AMERICA,
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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

J. Strickland & Co., a Tennessee corporation, with its principal place of business at Memphis, Tennessee, petitions the Supreme Court of the United States to issue a writ of certiorari to the United States Court of Appeals for the Sixth Circuit to review its judgment entered in the above-entitled case on November 29, 1965, and its action in entering an order on January 13, 1966, denying a Petition for Rehearing.

OPINIONS BELOW

The Findings of Fact, Conclusions of Law and Order for Judgment of the District Court apparently is not reported in F. Supp. but appears in 14 AFTR2d 5052 (May 29, 1964). (Appendix to Brief of Appellant, p. 276a.) The opinion of the United States Court of Appeals for the Sixth Circuit is reported in 352 F.2d 1016 (U.S.C.A. 6, November 29, 1965), 16 AFTR2d 5999. (App. A2.) The order of the Court of Appeals denying the Petition for Rehearing is reported in ..... F.2d ..... (U.S.C.A. 6, January 13, 1966). (App. A9-A10.)

JURISDICTION

The jurisdiction of this Court is invoked because the Court of Appeals has so far departed from the accepted and usual course of judicial proceedings as to call for an exercise of this Court's power of supervision. The judgment of the Court of Appeals vacating the judgment of the District Court and remanding the cause with instruction to dismiss the complaint was entered on November 29, 1965. The order of the Court of Appeals denying the Petition for Rehearing *en banc* and directing that the Petition for Rehearing be considered by the panel which heard the case was entered on January 13, 1966; the order of the Court of Appeals denying the Petition for Rehearing was entered on January 13, 1966. The jurisdiction of the Supreme Court is invoked under Title 28, U.S.C., Section 1254(1).

QUESTION PRESENTED

May a United States Court of Appeals so disregard the admonitory instructions of Rule 52(a) of the Rules of Civil Procedure for the United States District Courts[1] that a careful, thorough trial in the District Court before an able, experienced judge, who arrives at a considered judgment after a patient hearing and who arrives at a judgment based upon substantial evidence and supported by an opinion prepared with obvious care which analyzes the evidence and shows the reasons for the findings, becomes merely a preliminary skirmish to a battle to be waged *ab initio* in the Court of Appeals.

STATEMENT

The petitioner, J. Strickland & Co., as plaintiff, brought an action under the provisions of Title 28, U.S.C., Section 1346(a) (1), in the United States District Court for the Western District of Tennessee, seeking a refund of Federal income taxes and interest in the amount of $106,711.30, with interest as provided by law.

The question presented to the District Court for determination was whether a transaction entered into on October 1, 1955, between J. Strickland & Co. and Newbro Manufacturing Company constituted a license or a sale. The District Court, after seeing and hearing eleven witnesses testify, all of whom were offered by plaintiff and six of whom had direct association with and knowledge of the transaction of October 1, 1955, and whose credibility was at no time impugned; after considering at least

1. Rule 52(a) of the Federal Rules of Civil Procedure provides in part:

"Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses."

fifty-five exhibits of documentary evidence encompassing a tremendous mass of written and printed matter; after weighing any opposing evidence; after determining the credibility of the witnesses; after choosing between possible permissible inferences, decided that the transaction of October 1, 1955, between J. Strickland & Co. and Newbro Manufacturing Company was intended to create and did create the legal relationship of licensor and licensee.

The Government appealed to the United States Court of Appeals for the Sixth Circuit; that Court ordered the judgment of the District Court be vacated and the cause remanded with instructions to dismiss the complaint. (App. A1.) The Petition for Rehearing was denied. (App. A9-A10.)

REASONS FOR GRANTING THE WRIT

The United States Court of Appeals for the Sixth Circuit has expanded Rule 52(a) of the Federal Rules of Civil Procedure by disregarding its plainly expressed limitations.

This Court has not hesitated to convey to the lower Federal Courts its wisdom and instructions with respect to the interpretation and application of the Federal Rules of Civil Procedure in appropriate instances. In *Schlagenhauf* v. *Holder*, 379 U.S. 104, 85 S. Ct. 234 (1964), the Court, speaking through Mr. Justice Goldberg, at page 112, said:

> "However, in this instance the issue concerns the construction and application of the Federal Rules of Civil Procedure. It is thus appropriate for us to determine on the merits the issues presented and to formulate the necessary guidelines in this area. See Van Dusen v. Barrack, 376 U.S. 612. As this Court stated in Los Angeles Bus Manufacturing Corp. v.

> James, 272 U.S. 701, 706, '[W]e think it clear that where the subject concerns the enforcement of the . . . Rules which by law it is the duty of this Court to formulate and put in force . . . it may . . . deal directly with the District Court.'"

Petitioner prays this Court to exercise its power of correction recognized by this Court in speaking through Mr. Justice Douglas in *United States* v. *Munsingwear*, 340 U.S. 36 (1950), at page 40, 71 S. Ct. 104:

> "Our supervisory power over the judgments of the lower Federal Courts is a broad one."

Petitioner prays that the Court of Appeals for the Sixth Circuit may be made aware of the fact that it has failed to act in accordance with the standards of proper procedure and without consistency in applying the Federal Rules of Civil Procedure. *Duke Power Co.* v. *Greenwood Co.*, 299 U.S. 259 (1936), 57 S. Ct. 202.

This Court, in *United States* v. *Yellow Cab Co.*, 338 U.S. 338 (1949), 70 S. Ct. 177, speaking through Mr. Justice Jackson in a statement so lucid and literate that it should serve for all time as the "communication satellite," conveyed the message of the appellate function. The Court of Appeals failed to grasp the message.

Again, in *United States* v. *Oregon State Medical Society*, 343 U.S. 326 (1952), 72 S. Ct. 690, Mr. Justice Jackson, speaking for the Court, at page 332, illumines Rule 52(a) of the Federal Rules of Civil Procedure. The import of this decision has escaped the Court of Appeals.

In *Oregon State Medical Society, supra*, Mr. Justice Jackson refers with approval to *Boyd* v. *Boyd*, 252 N.Y. 422, 429, 169 N.E. 632, 634, and excerpts the following from the opinion of the New York Court of Appeals:

> "Face to face with living witnesses the original trier of the facts holds a position of advantage from which appellate judges are excluded. In doubtful cases, the exercise of his power of observation often proves the most accurate method of ascertaining the truth * * *. How can we say the judge is wrong? We never saw the witnesses * * *. To the sophistication and sagacity of the trial judge the law confides the duty of appraisal. Boyd v. Boyd, 252 N.Y. 422, 429, 169 N.E. 632, 634."

The original trial herein was in the District Court before an able, experienced judge who arrived at a considered judgment after a patient hearing and arrived at a judgment supported by an opinion prepared with obvious care which analyzed the evidence and showed the reasons for the findings. The reliability of the trier of the facts is a significant element in the application of the appellate function. See *Moore's Federal Practice, Second Edition, Volume 5*, page 2616, at which the author says:

> "And another factor is the reliability of the trier of the facts. While appellate 'courts should be slow to impute to trial courts a disregard of their duties and responsibilities or a want of diligence or perspicacity in evaluating the credibility of witnesses and the weight of evidence,' the reputation and standing of the trial judge for experience, discernment, detachment, reliability, carefulness, probity and other qualities that combine to make judging the master's art cannot and should not be ignored."

The function of the trial judge and the reliability of the particular trial judge in this case as the "trier of the facts" has been recognized by the Court of Appeals for the Sixth Circuit. See *Georgia Casualty & Surety Company* v. *Dorothy Marie Knott et al.*, 345 F.2d 131 (C.A. 6, 1965), and *Carr* v. *American Universal Insurance Co.*, 341 F.2d 220 (C.A. 6, 1965).

The petitioner is not asking this Court to try the case *de novo* but it does pray this Court to inform the Court of Appeals that there is no sanctity in the words "clearly erroneous" which makes sacrosanct the action of the Appellate Court in engaging in a trial *de novo*.

Judge Learned Hand, in *United States* v. *Aluminum Company of America*, 148 F.2d 416 (C.A. 2, 1945), said:

> "It is idle to try to define the meaning of the phrase 'clearly erroneous;' all that can be profitably said is that an appellate court, though it will hesitate less to reverse the findings of a judge than that of an administrative tribunal or of a jury, will nevertheless reverse it most reluctantly and only when well persuaded. This is true to a considerable degree even when the judge has not seen the witnesses. . . . However, whatever may be said in favor of reversing a trial judge's findings when he has not seen the witnesses, when he has, insofar as his finding depend upon whether they spoke the truth, the accepted rule is that 'they must be treated as unassailable.'"

It is possible but by no means a certainty that the Division of the Court of Appeals would not have decided this case as did the trial Judge if the Division had been the trier of the facts in the first instance; but this begs the issue. The Government offered no witnesses. Thus, when an Appellate Court which has not seen the eleven witnesses of plaintiff testify, six of whom had direct and pertinent knowledge of the transaction involved (five of the witnesses had no direct knowledge of the transaction), and the testimony encompassing two hundred and thirty pages of a printed record is supported by fifty-five items of documentary evidence embracing several hundred pages, can say, as it must, that there was no substantial evidence to support the findings of fact of the trial Judge, such statement must represent the expression of an attitude rather

than a reasoned conclusion and effects a departure from the accepted and usual course of judicial proceeding, the guidelines for which are clearly set forth in Rule 52(a) of the Federal Rules of Civil Procedure.

It would hardly seem in view of the opinion of this Court in *United States* v. *Yellow Cab Co., supra,* it would be necessary to call a Court of Appeals back into its proper orbit with respect to its appellate function; but if, as in this case, the Findings of Fact of the District Court which are demonstrably supported by substantial evidence can be set aside as "clearly erroneous" then information with respect to such principle should come from this Court and the Court of Appeals should not be permitted to usurp the function of this Court.

CONCLUSION

The petitioner respectfully prays that the Writ of Certiorari be granted to the end that the Court of Appeals' departure from the accepted and usual course of judicial proceedings may be corrected.

Respectfully submitted,

JOHN R. STIVERS

TAYLOR MALONE, JR.
Attorneys for Petitioner

United States Court of Appeals

FOR THE SIXTH CIRCUIT

No. 16,225

J. STRICKLAND & COMPANY,
Plaintiff-Appellee

vs.

UNITED STATES OF AMERICA,
Defendant-Appellant.

(Filed November 29, 1965. Carl W. Reuss, Clerk)

BEFORE: WEICK, Chief Judge, CONNELL and MACHROWICZ, District Judges.

Judgment

APPEAL from the United States District Court for the Western District of Tennessee

THIS CAUSE came on to be heard on the record from the United States District Court for the Western District of Tennessee and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be and the same is hereby vacated and the cause remanded with instructions to dismiss the complaint.

No costs awarded. Rule 23(4).

Entered by order of the Court.
/s/ Carl W. Reuss
Clerk

No. 16,225

United States Court of Appeals

FOR THE SIXTH CIRCUIT

J. STRICKLAND & COMPANY,
Plaintiff-Appellee,

v.

UNITED STATES OF AMERICA,
Defendant-Appellant.

ON APPEAL from the Judgment of the United States District Court for the Western District of Tennessee.

Decided November 29, 1965.

(Filed November 29, 1965. Carl W. Reuss, Clerk)

Before WEICK, Chief Judge, CONNELL* and MACHROWICZ**, District Judges.

WEICK, Chief Judge. The Government has appealed from a judgment rendered against it by the District Court in the amount of $106,711.30, in an action to recover refund of income taxes alleged to have been erroneously assessed and collected for the tax years of 1956 through 1959.

The sole issue was whether an agreement entered into between taxpayer, J. Strickland & Company, and Newbro Manufacturing Company on October 1, 1955, constituted a contract of sale or a license of certain trademarks. In the case of the former, payments made thereunder would be treated for income tax purposes as purchase money, rather than as royalty payments.

*Honorable James C. Connell, United States District Judge, for the Northern District of Ohio, sitting by designation.

**Honorable Thaddeus M. Machrowicz, United States District Judge, for the Eastern District of Michigan, sitting by designation.

The District Court in adopting findings of fact and conclusions of law found that the contract created a relationship of licensor and licensee rather than seller and buyer, and that the payments of $167,392.57 in the four tax years in question were royalties and not purchase money, and could be deducted from income as ordinary business expenses under Sec. 162(a) of the Internal Revenue Code of 1954 (26 U.S.C. § 162(a)).

Both Strickland and Newbro had been engaged in the manufacture and sale of cosmetics. Newbro engaged a broker in New York to sell its machinery, inventory, trademarks and trade names and supplied him with confidential information as to sales of five of its principal products, during the fiscal years 1951-1954. The broker brought the two parties together and they entered into a series of transactions on or about October 1, 1955.

Newbro by two separate agreements and bills of sale sold its raw materials, inventory and manufacturing equipment to Strickland for about $70,000, payable in cash. In the third agreement Newbro appointed Strickland its exclusive manufacturer and sales representative of its five principal products for a term of five years, with the option of either party to renew from year to year on the same terms and conditions, but not to exceed three years' renewal. Strickland was required to pay all expenses of the manufacture, sale and promotion of said products. Newbro agreed to register the trademarks for the products and to keep them in force.

Strickland was to receive seventy-five per cent of the net profits, or in lieu thereof, at the option of either party, was required to pay Newbro a percentage of the net sales on a declining percentage basis, with a minimum guaranteed payment of $35,700 per year. Newbro elected to re-

ceive the percentage of net sales with the minimum guarantee.

Three major stockholders of Strickland, controlling 97% of its stock, formed a partnership under the name of The Fourteen Hundred Co. (Fourteen). In an instrument labeled "Escrow Agreement", which was the fourth agreement in the series, Fourteen was granted an option to purchase, for $20,000, the trademarks of the products which were the subject of the licensing agreement. One thousand dollars was paid in cash, and assignments of the trademarks were placed in escrow. The option could be exercised at any time after September 30, 1960, but prior to September 30, 1961.

Strickland commenced performance and for the tax years in question made the following alleged royalty payments to Newbro:

Year	*Payments Made*
1956	$ 42,941.81
1957	41,956.47
1958	43,929.15
1959	38,565.14
Total	167,392.57

The option contained in the Escrow Agreement was exercised in 1960, and Newbro received the balance due thereon of $19,000.

In its income tax returns Strickland took deductions from income for the above payments, and Newbro reported the payments it received in its income tax returns as ordinary income.

Oral testimony was offered by Strickland tending to prove that it did not want to purchase the business of Newbro but desired only to purchase the inventory, ma-

chinery and equipment, and to obtain a license to manufacture and sell the trademarked articles on a royalty basis.

In addition to the oral testimony, however, letters passing between the parties threw light on their real intent and purpose. In the letter of December 31, 1954 from Elliott Goldstein, counsel for Newbro, to George Long, President of Strickland, the purpose of having the license agreement was discussed.[1] Later, on August 4, 1955, Mr. Goldstein wrote to patent counsel, sending him copies of the agreements and asking advice relative to the patent and trademark angle. He made a further statement relative to the tax situation.[2] On August 4, 1955 Mr. Long wrote to Mr. Goldstein.[3]

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1. "Similarly, we recognize that after the first five years have been paid, only a nominal royalty should be paid, and that you are primarily interested in making sure that the payment is a true royalty, which will be deductible by you.

"As you pointed out, a certain amount of give and take will be involved in working out the details of the royalty agreement. We can state, however, that we are agreed in principle to the idea that any royalty agreement must be one which will be deductible by you, and in order to effectuate this, our client is prepared to sacrifice any capital gains benefits, if necessary, and permit the contract to be drawn in such a way that the payments will be considered ordinary income to it. We do not know that this will be necessary, but wish to assure you that any reasonable concessions will be made by Newbro that are necessary to assure you of the deductibility of the payments made by you under the contract."

(Append. p. 263a)

2. "You will note that this agreement was drawn in such a way as to attempt to assure the purchaser that he would receive a deduction for the sums paid to Newbro."

(Append. p. 272a)

3. "We do think, however, that we have not as yet reached the most important part in the negotiations and that is a closer meeting of minds in the final figure. Before we do attempt a meeting, we want to clarify our viewpoints:

"In our franchise proposal we guarantee you, over a period of five years, $180,000 plus $20,000 in the option, or a total of $200,000.00, plus the real worth or depreciated value of the equipment, plus the true value of your usable and saleable inventory under these four trade names."

(Append. p. 270a)

In a letter dated September 7, 1955, from Newbro to its broker, the understanding "with respect to your commission on the sale" was reduced to writing.

Mr. Long's letter of August 4, 1955 made it clear that Newbro would receive a guarantee of $270,000 for all the assets embraced in the agreements, including $20,000 under the option.

The guaranteed minimum royalty payments over a period of five years, totaling $178,500, for the use of the trademarks, seem inordinately large if Strickland was acquiring no interest in the marks. They substantially exceeded in each year the net profits realized by Strickland from the manufacture and sale of the products. They were thus greatly in excess of reasonable royalties.

Furthermore, the evidence disclosed that Strickland was expending large sums in advertising and promoting the products covered by the trademarks. This would be most unusual if the marks were to remain the property of Newbro.

We are convinced from a review of the record as a whole that the real agreement between the parties was a sale of the trademarks, although it was thinly disguised for tax purposes as a license.

The transparency of the transaction was not obliterated by taking the option to purchase the marks in the names of the controlling shareholders through the partnership instead of in Strickland's name. In effect, control of the marks still remained in Strickland. The Commissioner could and did look through the form to the substance and treated Strickland and its controlling shareholders as one for tax purposes.

Since Strickland controlled the option, it had the right to acquire title to the marks, and had an equitable interest in them to the extent of the payments which it made. These payments should be considered as having been made on the purchase price and not treated as royalties. *Haggard* v. *Commissioner*, 241 F.2d 288 (9th Cir. 1956); *Oesterreich* v. *Commissioner*, 226 F.2d 798 (9th Cir. 1955).

With such a large equity in the marks and substantial investment in advertising, it was practically certain that the option would be exercised. Exercising the option required only a payment of about ten per cent of the total consideration for the marks. Had the option not been exercised, Newbro could have continued the agreement in effect for three more years on the same terms and conditions. Strickland sought to prove by oral testimony that the guaranteed minimum royalty would not be required to be paid in the renewal period, but this evidence, in our opinion, would have varied the terms of the written agreement.

The District Court found that during the course of the negotiations Newbro had declined to furnish financial information to Strickland. The evidence was clear, however, that before closing the deal Newbro had agreed to furnish such information and even to permit an examination of its books and records. (Appendix, pp. 266a, 267a).

Another finding of the District Court was made to the effect that taxpayer wanted the licensing agreement because of possible liability growing out of the sale of one of the products used for straightening hair, called "Silky Strate". This finding seems to overlook the proposition that if Strickland manufactured and sold to the public an inherently dangerous product, the fact that it was operating under a license agreement instead of holding the legal

title to the trademarks would not constitute a defense. In any event, Strickland had substantial insurance coverage on all the products. Furthermore, a product known as "Tuxedo Club" was the one which Strickland wanted to obtain and was the real purpose of the agreement.

In our judgment, the finding of the District Court that the agreement was one of license instead of sale was clearly erroneous. *United States* v. *United States Gypsum Co.*, 333 U.S. 364 (1947).

The judgment of the District Court is vacated and the cause is remanded with instructions to dismiss the complaint.

No. 16,225

United States Court of Appeals

FOR THE SIXTH CIRCUIT

J. STRICKLAND & COMPANY,
Plaintiff-Appellee,

vs.

UNITED STATES OF AMERICA,
Defendant-Appellant.

Order

(Filed January 13, 1966. Carl W. Reuss, Clerk.)

Before WEICK, Chief Judge, O'SULLIVAN, PHILLIPS, EDWARDS, CELEBREZZE, Circuit Judges, and CONNELL and MACHROWICZ, District Judges.

Upon consideration of the petition for rehearing en banc, it is ORDERED that it be denied and that the petition for rehearing be considered by the panel which heard the case.

Entered by order of the Court.

/s/ Carl W. Reuss
Clerk

No. 16,225

United States Court of Appeals

FOR THE SIXTH CIRCUIT

J. STRICKLAND & COMPANY,
Plaintiff-Appellee,

vs.

UNITED STATES OF AMERICA,
Defendant-Appellant.

Order

(Filed January 13, 1966. Carl W. Reuss, Clerk.)

Before WEICK, Chief Judge, CONNELL and MACHROWICZ, District Judges*.

Upon consideration, it is ORDERED that the petition for rehearing herein be denied.

Entered by order of the Court.

/s/ Carl W. Reuss
Clerk

*Honorable James C. Connell, United States District Judge, for the Northern District of Ohio, sitting by designation; and Honorable Thaddeus M. Machrowicz, United States District Judge, for the Eastern District of Michigan, sitting by designation.